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No. 88-1766

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

CHARLES S. FOLTZ *et al.*,
Petitioners,
v.
U.S. NEWS & WORLD REPORT, INC., *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia

BRIEF IN OPPOSITION FOR RESPONDENTS

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QUESTION PRESENTED

Does either Section 404(a) or 103(b) of the Employee Retirement Income Security Act of 1974 invalidate a provision in an employee benefit profit-sharing plan that directs that the shares of employer stock held by the plan, which, in the aggregate, constitute a majority of the outstanding shares, be valued annually at their fair market value on a minority interest basis?

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BRIEF IN OPPOSITION FOR RESPONDENTS *

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A) is reported at 865 F.2d 364. The opinion of the district court (Pet. App. B) is reported at 663 F. Supp. 1494.

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* In compliance with Rule 28.1 of the Rules of this Court, the respondents state as follows: American Appraisal Associates, Inc., is wholly owned by RLM Investments, Inc., and has no subsidiaries or affiliates in which any member of the public owns any interest. U.S. News & World Report, Inc., has the following affiliates: U.S. News & World Report L.P., Boston Properties, Applied Graphics Technologies, L.P., Kordet Color Corp., Kordet Color Systems, Inc., The Atlantic, Inc., and ZWA, Inc. None of these firms is publicly held. The remaining respondents are not corporations.

STATEMENT OF THE CASE

U.S. News & World Report, Inc. ("U.S. News") was organized in 1962 to effectuate David Lawrence's long-standing wish to bring about complete employee ownership of U.S. News. Most of the stock of the predecessor corporation, U.S. News Publishing Co., was beneficially owned by Lawrence's family, with a limited group of "key" employees holding the remaining shares. After a reorganization, the U.S. News Profit-Sharing Plan (the "Plan") owned about 25 per cent of the shares of U.S. News, with the remaining shares distributed among those key employees, no one of whom held a majority interest. It was foreseen, however, that as the key employees retired and sold their shares back to the company, shares held by the Plan would eventually become a majority. In the early 1970s that in fact occurred.[1]

The plan document which governed the Plan provided that when a participant's employment with U.S. News terminated, by retirement or otherwise, he could receive the value of his proportionate interest in the Plan's assets. Paragraph 6.3 of the plan document provided generally that the Plan's assets would be valued at "market values" and, more specifically, that its shares of U.S. News stock would be valued at the "fair market value established under Article Fifth, Paragraph (e)" of the U.S. News Certificate of Incorporation. This was the value that U.S. News was required to use to redeem the minority stock interests held directly by the key employees and the bonus shares owned later by other employees. See n. 1, *supra*.

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[1] In 1963, U.S. News inaugurated a stock bonus plan whereby employees were periodically awarded small amounts of U.S. News stock. Even in the aggregate, however, the shares directly held by employees through the stock bonus plan never amounted to a significant proportion of the total.

The term "fair market value," as applied to the common stock of a corporation, can have one of at least two meanings, depending upon the circumstances of the valuation. The first, most often obtained from the tables of prices included in the financial section of the morning newspaper, is frequently described—and was so described throughout this litigation—as the fair market value "on a minority interest basis." The second, the price that a buyer might under certain circumstances be willing to pay, per share, for all or most of the shares of a corporation, is often called the fair market value "on a control basis." The second amount is often a higher one. The fair market value of the U.S. News stock held by the Profit-Sharing Plan was always determined on a minority interest basis, even though, during the period covered by this litigation, the Plan owned more than 50 per cent of the company's outstanding shares. As the lawyer who drafted the plan document explained, the Plan was to serve as the mechanism whereby U.S. News employees each would own, indirectly, minority interests in the company, and so it was determined at the outset that the minority interest value established by Article Fifth(e) for the U.S. News shares that were held by employees directly should also be used to value the U.S. News shares held by the Plan. Pet. App. 79a, 76a.

In 1984, several months before the company was sold to a third party, this action was filed against U.S. News, four U.S. News directors and the independent appraisal company that did the annual appraisals of U.S. News stock. Subsequently, the Plan and several additional directors were added as parties. The lengthy trial, and the massive filings referred to by the court of appeals, Pet. App. 20a, were attributable in part to the many claims for relief involving disputed questions of fact asserted against several defendants. The court of appeals recognized that the lynchpin of the petitioners' case was their

argument that the U.S. News shares held by the Plan should have been valued on a control basis. Accordingly, the court focused on that question, and, having resolved it in favor of the respondents, affirmed without extended discussion the decisions of the district court with respect to the many other claims initially asserted by the petitioners. Pet. App. 4a, nn. 3 and 4; 20a.

The district court found that the fiduciaries of the Profit-Sharing Plan had interpreted the plan document to require the Plan's shares to be valued on a minority basis and held that that interpretation was reasonable and not arbitrary. Pet. App. 54a-91a. In the course of its analysis the court examined, with the assistance of substantial expert testimony, how the shares held by the Plan should have been valued based solely on the application of valuation principles under the existing facts and circumstances, without reference to the terms of the plan. It found that even without considering the terms of the plan, it was proper to value the Plan's U.S. News shares on a minority-interest basis. Pet. App. 79a-91a.

The court of appeals arrived at the same destination by a straighter route. It held that the plan document directed the fiduciaries to value the U.S. News shares held by the Plan using the per share value arrived at under Article Fifth(e) of the Certificate of Incorporation (Pet. App. 10a) and that that value was inevitably and properly determined on a minority basis (Pet. App. 4a-8a). The court concluded, as "a matter of contract and trust law, therefore, the Plan correctly used a figure computed on a minority basis." Pet. App. 10a. The court then considered, and rejected, the petitioners' arguments that the plan document, so construed, was inconsistent with valuation principles used in estate tax cases, and that the conduct of the fiduciaries in carrying out the terms of the plan violated their fiduciary obligations under § 404(a) of the Employee Retirement Income Security Act of 1974 ("ERISA") and responsibil-

ities imposed by the reporting requirements of § 103(b) of that act. Pet. App. 10a-20a.

ARGUMENT

I. Petitioners Seek Review of a Decision That Was Not Made by the Court Below.

Although petitioners do not contest directly the correctness of the court of appeals's ruling that the plan document mandated the use of the minority interest fair market value, they repeatedly assert that the court of appeals acknowledged that the U.S. News stock was "undervalued . . . for the purpose of preserving employee ownership." This serves as the basis for the further assertion that the court of appeals erred in ruling that this "undervaluation" for such a "purpose" did not violate the two provisions of ERISA upon which petitioners rely. The court of appeals made no such ruling. It found, as did the district court, that the Plan's U.S. News shares were *not* undervalued to further corporate objectives—indeed, both courts found that the stock was not undervalued at all. Pet. App. 10a-15a; Pet. App. 78a-89a. The court of appeals held, only and explicitly, that neither § 404(a) nor § 103(b) made it unlawful for the fiduciaries of the Plan to carry out the provisions of the plan document mandating the minority interest valuation of the Plan's stock. Pet. App. 15a-20a. The only issue that may fairly be raised by the petition is whether these rulings are of sufficient importance to call for review by this Court. We show below that the two rulings attacked by the petition were correct and represented quite unremarkable interpretations of ERISA. We show also, contrary to the unsupported claims in the petition, that the decision below is likely to have very little impact beyond the parties in this case and that the issues raised by the petition are unlikely to arise again.

II. The Rulings of the Courts Below Were Fully Considered and Correct.

A. The terms of the Plan respecting valuation do not violate § 404(a) of ERISA.

Section 404(a) requires plan fiduciaries to act ". . . for the exclusive purpose of providing benefits to participants. . . ." That language, on its face, does not address the question of what a plan document may or may not provide with respect to how the plan's assets shall be valued. As the court of appeals noted, this Court established in *Alessi* v. *Raybestos-Manhattan, Inc.*, 451 U.S. 504, 511 (1981) that "the fiduciaries' duties are found largely in the terms of the Plan itself" (Pet. App. 16a), and Section 404(a)(1)(D) by its terms requires the fiduciaries to act "in accordance with the documents and instruments governing the plan." [2]

Moreover, the "exclusive purpose of providing benefits" rule of § 404(a)(1) does not preclude a sponsor from prescribing, in the plan document, a method of valuation that is consistent with, and supportive of, employee ownership. As the court of appeals said, "ERISA's evident approval of ESOPs precludes any claim that it forbids employee ownership as a legitimate plan objective." Pet. App. 16a.[3] The Court observed that using a minority

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[2] Section 404(a)(1)(D) requires that the fiduciaries carry out their duties "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter or subchapter III of this chapter." Since neither § 404 nor the remainder of ERISA provides a specific direction as to what method of valuation should be used in this situation, § 404(a), in fact, *required* the fiduciaries to follow the method prescribed in the plan document for valuing the stock and thus determining the benefits paid to plaintiffs. As this Court stated in *Alessi*, ERISA leaves the question of the level of benefits "largely to the private parties creating the plan." 451 U.S. at 511.

[3] An ESOP is defined as a "defined contribution plan which . . . is designed to invest primarily in employer securities. . . ." I.R.C. § 409(a).

basis to determine the per share value of the shares held by the Plan was consistent with the Plan's objective of continuing employee ownership. A control premium could only be realized if the Plan sold control of U.S. News to a third party. An actual sale of the company would, however, thwart one of the Plan's purposes, while valuing the shares on the basis of a hypothetical sale would mean paying out wealth that the Plan did not have and could not receive without an actual sale. *Id.* The court also held that, even if § 404 were interpreted as requiring plan fiduciaries to maximize the benefits paid to participants (although its own view was otherwise, Pet. App. 16a), the valuation provision of the plan document was consistent with that aim. Pet. App. 16a-17a.

Of course, fiduciaries are not excused from the duty to make prudent investment decisions, *Fink* v. *National Savings & Trust Co.*, 772 F.2d 951 (D.C. Cir. 1985), or to refrain from misusing plan assets for their own ends, *Eaves* v. *Penn*, 587 F.2d 453 (10th Cir. 1978), merely because a plan has the objective of providing employees with an ownership interest in their company. But that objective surely may be taken into account as a relevant factor in structuring and administering plans. Petitioners' effort to compare this case to cases where fiduciaries used plan assets to finance or resist takeover attempts for the benefit of management, e.g., *Leigh* v. *Engle*, 727 F.2d 113 (7th Cir. 1984); *Donovan* v. *Bierwirth*, 680 F.2d 263 (2d Cir. 1982), or structured the plan to penalize non-membership in a union, *Deak* v. *Masters, Mates & Pilots Pension Plan*, 821 F.2d 572 (11th Cir. 1987), completely misses the mark.

B. The terms of the Plan are not inconsistent with § 103(b) of ERISA.

Section 103(b) requires employee benefit plans to report their assets at "current value," which is defined in § 3(26) as "fair market value where available and otherwise the fair value as determined in good faith by a

trustee or a named fiduciary . . . *pursuant to the terms of the plan* . . . , assuming an orderly liquidation at the time of such determination." (Emphasis supplied.) The petitioners argue that "current value" simply means "fair market value," and we will assume, arguendo, that they are right.[4] The question, however, is whether, under the facts and circumstances presented here, the "fair market value" of the shares held by the Plan should be determined on a minority basis or on a control basis.

The statute provides no guidance on this question. The petitioners urge, however, that the answer is to be found in estate tax cases, *Estate of Curry* v. *United States*, 706 F.2d 1424 (7th Cir. 1983), *Estate of Bright* v. *United States*, 658 F.2d 999 (5th Cir. 1981) (en banc), which, they say, hold that a person's intentions with respect to his assets have no bearing on their value. The court of appeals took no issue with such cases within their appropriate context of valuation for the purpose of determining liability for estate taxes. Pet. App. 12a-13a. It merely held that the context here—valuation of employer stock held by an employee benefit plan that was designed and structured to serve as a vehicle for employee ownership—requires, or at least permits, plan sponsors to provide for a different result. Pet. App. 13a. The petitioners criticize the court of appeals's holding in this regard as "invit[ing] abuse of plan asset valuations by embracing the introduction of subjective factors into the valuation process." Pet. App. 26. But the court's decision did nothing of the kind. It merely recognized that

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[4] For purposes of this brief, we also assume, as did the court of appeals, that § 103(b), which on its face governs only *reporting* requirements, and which is one of the sections of ERISA that includes the recurring requirement that fiduciaries must act in accordance with the terms of the plan, has some bearing upon the valuation of plan stock for the purpose of determining benefits. The district court held otherwise (Pet. App. 65a), a determination with which the court of appeals did not disagree. We believe that the district court's holding is correct.

where a plan serves the purpose of providing for employee ownership—as ERISA permits and even encourages—it would make little sense to require it to value its holding of employer stock on the assumption that this purpose will be abandoned.

We submit that both of the rulings for which petitioners seek review are perfectly straightforward and unremarkable interpretations of the act that, of themselves, do not call for further review.

III. The Issues in This Case Are of Little General Significance.

The specific holdings of the court of appeals on the application of the exclusive purpose rule in this case and the interpretation of ERISA § 103(b) are narrow and will have very little applicability beyond the precise factual circumstances presented here.[5] More broadly, however, the basic valuation question presented in this case—whether it is valid for a defined contribution profit-sharing plan that owns a controlling block of the sponsoring employer's stock to provide for an annual valuation of that stock at its minority interest fair market value—can rarely arise.

In 1962 U.S. News was in the vanguard of the movement toward employee ownership and was one of the early companies to use an employee benefit plan to achieve that aim. The Plan was established as a vehicle for employee ownership long before the enactment of ERISA and the adoption of numerous provisions of the Internal Revenue Code that encourage employee ownership by providing highly favorable treatment for ESOPs. See *Donovan* v. *Cunningham*, 716 F.2d 1455, 1458, 1466

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[5] It is worth noting, in this regard, that in nearly 15 years the interplay between the reporting requirements of § 103(b) and the definition of "current value" in § 3(26) appears to have been litigated only once—in this case.

nn. 23 and 24 (5th Cir. 1983). Because of the tax advantages they enjoy, ESOPs have become by far the most prevalent form of benefit plan providing for employee ownership. C. Rosen *et al.*, *Employee Ownership in America* 17 (1986).

In its most significant features, the Plan is virtually identical to an ESOP. Both are individual account employee benefit plans. ERISA § 3(34). An ESOP is by definition a mechanism through which employees own the stock of the corporations for which they work, ERISA § 407(d)(6), and many ESOPs own all or most of that stock, C. Rosen, *supra* at 16. In this respect ESOPs function just as the U.S. News Plan did.

In one important respect, however, the Plan was structured differently from today's ESOP. The plan document provided, in Paragraph 6.4, that each employee's account would be "the value of his undivided share" of the Plan's assets, including the U.S. News stock. ESOPs, on the other hand, characteristically allocate to each employee a specific number of shares of the employer's stock. When an employee retires or terminates his employment, he is usually entitled to receive the shares allocated to him.[6] If those shares are publicly traded, the employee can, of course, sell them in the open market, where he will receive their fair market value on a minority interest basis. If the shares are not publicly traded, however, the employee typically receives a "put" option requiring the employer to repurchase the stock at its "fair market value." See 29 C.F.R. §§ 2550.407d-6(a)(6), 2550.408b-3(j), (k), and (l); 26 C.F.R. § 54.4975-11(d)(5). Since

[6] Section 407(d)(6) of ERISA defines an ESOP as an individual account plan "which is a stock bonus plan which is qualified, or a stock bonus plan and money purchase [plan] both of which are qualified, under section 401 of title 26 [the Internal Revenue Code], and which is designed to invest primarily in qualifying employee [sic] securities . . . ." Section 409(h)(1)(A) of the Code requires that a participant who is entitled to a distribution from such a plan be given "a right to demand that his benefits be distributed in the form of employer securities."

the number of shares given to each retiring employee is in every case relatively small, even under the petitioners' theory the question of which of two fair market values to use simply does not arise. The minority interest being purchased is necessarily valued at its fair market value on a minority interest basis, even when the ESOP's aggregate holding of employer stock constitutes a majority of the outstanding shares.[7] Thus, ESOPs achieve the same result that the drafters of the U.S. News Plan intended to achieve—a minority interest valuation of employer stock—but in a way that prevents the question presented here from ever arising. This case is not likely to have any impact beyond the parties to this action.

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[7] Where the employer's charter or bylaws restricts the ownership of substantially all outstanding employer securities to employees and to the plan itself, an ESOP may (notwithstanding I.R.C. § 409(h)(1)(A)) preclude the actual distribution of employer securities allocated to the participant's account, as long as the participant has the right to receive his benefits in cash. § 409(h)(2). Of course, since the cash benefit is equivalent to the value of the shares allocated to the participant's account, and those shares are invariably minority interests in the company, they are properly valued on a minority interest basis.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted,

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